



Irving Trust

Financial Markets^{2/15/84}

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**Economic Research &
Planning Division**

Friday
(Noon)

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On February 7, Chairman Volcker testified before the House Banking Committee as he is directed to do by the "Humphrey-Hawkins" Act. The previous day, the Fed had released the targets for money and credit for 1984. The chairman's testimony centered on the justification for the targets and the Fed's outlook for the economy in 1984 under these targets. Committee members pressed the chairman for his views on the budget deficit: How big a problem is it? What can be done? In answering these questions, Mr. Volcker drew connections between the federal budget deficit and the burgeoning current account deficit. His response has put the inflation fight and prospects for the dollar's foreign exchange value in the limelight.

The chairman took a tough stance, directly confronting the election year pressure: "Markets have a mind of their own; they have never waited on the convenience of kings or Congressmen--or elections." Having said this, Mr. Volcker described why Fed policy would be essentially helpless in bringing interest rates down this year unless the pace of economic activity slows. The Fed's desire to fight inflation means that market forces themselves will have to work to produce lower rates if rates are to decline. To use monetary policy to force rates down would be self-defeating in terms of inflation.

According to Mr. Volcker, budget deficits are the central problem. They increase our domestic savings requirements and have led to high interest rates. Our failure to save enough to self-finance the deficits--and to supply sufficient funds to the private sector--means that we must consume less and save more or produce more. The strong dollar is responsible for this poor consumption-production mix and has led to a huge deficit in our current account. To balance our international payments, capital has poured into the U.S.; in 1984, Mr. Volcker estimates, about \$80 billion will be needed, about 2% of GNP. In the short run, this is fine, but it's not sustainable over the long haul. For now, the strong domestic demand (a 7% real growth rate in the fourth quarter of last year) helps to stimulate foreign economies. But if we continue to run large external deficits, the time will come when the U.S. will become a net borrower instead of a net lender. Chronic dependence on foreign capital would make our currency vulnerable. A sharp decline in the dollar would not stimulate domestic production as much as it would inflation, so that's not the answer.

This is why monetary policy cannot be used to force the dollar lower. The dollar might decline but cannot drop sharply because that would precipitate inflation. Should the dollar weaken too much, the Fed would react with a tighter policy to blunt the inflationary effects of dollar depreciation. A tighter monetary policy would also help arrest the dollar's decline. So I conclude that, in some sense, the dollar can't drop sharply this year. With this logic Mr. Volcker has not sounded an immediate warning. For now, the expansionary policies are not necessarily bad for the U.S. or the world--they may in fact be good. He cautions about the future, however. The budget deficits are the key to this rather complicated interrelated system, which draws in the external payments imbalance and focuses on the dollar. If deficits can be reduced, this menace is alleviated. But in this scheme of things, the U.S. current account also is a key, and the federal deficit doesn't totally determine this account. Policies abroad will be important in 1984--more foreign growth would help.

Robert A. Brusca



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Market Yields

	2/10/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	11.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	8.50
Federal Funds	9.44	9.44	8.50
Repurchase Agreements	9.30	9.40	8.38
U.S. Treasury Issues			
Bills			
3 months	9.37	9.25	8.39
6 months	9.67	9.52	8.66
1 year	9.87	9.75	8.93
Coupons			
2 years	10.69	10.53	9.64
4 years	11.25	11.09	10.10
7 years	11.67	11.51	10.61
10 years	11.77	11.62	10.78
Long Bond	11.90	11.72	10.87
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.45	9.25	8.30
3 months	9.50	9.35	8.50
6 months	9.70	9.45	8.70
1 year	9.95	9.85	9.20
Banker's Acceptances			
1 month	9.55	9.25	8.30
3 months	9.70	9.35	8.45
6 months	9.65	9.55	8.70
Eurodollar Deposits			
1 month	9.75	9.63	8.78
2 months	9.88	9.69	9.00
3 months	9.94	9.75	9.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.45	9.45	8.51
1 month	9.55	9.45	8.56
3 months	9.60	9.44	8.68
Bank Holding Companies			
1 month	8.94	8.94	8.17
Dealer Placed:			
3 months	9.71	9.60	8.79
New AA Corporate Utility Bond	13.10	12.80	12.40
Tax Exempt			
6 month Project Notes	5.15	5.00	4.45
1 year AAA Bond	5.25	5.40	5.00
5 year AAA Bond	6.75	6.85	6.25
20 year AAA Bond	9.00	8.95	8.90

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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